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December 2002

Financial Audit

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For the Fiscal Year Ended June 30, 2001

Montana Water Pollution Control and Drinking Water State Revolving Fund Programs

Department of Environmental Quality
Department of Natural Resources and Conservation

We performed a financial audit of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs for the fiscal year ended June 30, 2001. This report contains the audited financial statements and accompanying notes for fiscal year 2000-01. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

Direct comments/inquiries to:
Legislative Audit Division
Room 160, State Capitol
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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Legislative Audit Division
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Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

December 2002

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the fiscal year 2000-01 financial audit of the Montana Water Pollution Control State Revolving Fund (WPCSRF) and Drinking Water State Revolving Fund (DWSRF) Programs. The Department of Natural Resources and Conservation requested the audit of these programs because annual audits are required by the federal Environmental Protection Agency.

The objectives of a financial audit include determining if the programs' financial statements present fairly their financial position at June 30, 2001, and the results of the programs' operations for the fiscal year then ended. We tested compliance with state and federal laws that have a direct and material impact on the financial statements.

The WPCSRF program provides loans at a reduced interest rate to finance construction of publicly-owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Water Pollution control loans must be repaid within 20 years. As of June 30, 2001, the Water Pollution Control Program had \$56,970,165 of outstanding loans.

The DWSRF provides low interest loans to communities for the construction of drinking water treatment facilities. Drinking water loans may be financed up to 30 years. At June 30, 2001, the Drinking Water Program had \$29,620,487 of outstanding loans.

On page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the presented information. The programs' financial statements begin on page A-3. Our opinion on the programs' supplementary financial information is on page B-1. The supplementary information begins on page B-3. Beginning on page C-1 is our report on compliance and internal control which is required by Government Auditing Standards issued by the Controller General of the United States. The departments have reviewed this report and agree with the contents.

We thank the directors of the Department of Environmental Quality and the Department of Natural Resources and Conservation and their staff for cooperation and assistance during the audit.

Respectfully submitted,
A handwritten signature in black ink, appearing to read "Scott A. Seacat".

Scott A. Seacat
Legislative Auditor

Appointed and Administrative Officials

Department of Environmental Quality

Jan Sensibaugh, Director

Tom Livers, Deputy Director

Ann Danzer, Administrator, Centralized Services Division

Department of Natural Resources and Conservation

Bud Clinch, Director

Anna Miller, Financial Advisor


Ann Bauchman, Administrator, Centralized Services Division

For additional information concerning the Montana Water
Pollution Control and Drinking Water State Revolving Fund
Programs, contact Anna Miller, Financial Advisor, at:

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The audit staff involved in this audit were Alexa O'Dell and Jennifer Solem.



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LEGISLATIVE AUDIT DIVISION

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INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

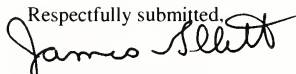
We have audited the accompanying Combined Balance Sheet of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs, as of June 30, 2001, and the related Combined Statement of Revenues, Expenditures, and Changes in Fund Balances for the year then ended. These financial statements are the responsibility of the management at the Montana Department of Environmental Quality and the Montana Department of Natural Resources and Conservation. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in the notes to the financial statements, the financial statements of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs are intended to present the financial position and results of operations of only that portion of the financial reporting entity of the State of Montana that is attributable to the transactions of the program.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of June 30, 2001, and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of the Legislative Audit Committee, department management, the Montana State Legislature, and the U.S. Environmental Protection Agency and is not intended to be, and should not be, used by anyone other than these specified parties. This report is a matter of public record and its distribution is not limited.

Respectfully submitted,

James Gillett, CPA
Deputy Legislative Auditor

October 16, 2002

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**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
STATE REVOLVING FUND PROGRAMS
COMBINED BALANCE SHEET
SPECIAL REVENUE AND DEBT SERVICE FUNDS
JUNE 30, 2001**

	<u>WATER POLLUTION CONTROL</u>		<u>DRINKING WATER</u>		(FOR MEMORANDUM ONLY) TOTAL
	<u>SPECIAL REVENUE</u>	<u>DEBT SERVICE</u>	<u>SPECIAL REVENUE</u>	<u>DEBT SERVICE</u>	
ASSETS					
Cash/Cash Equivalents	\$6,409,656	\$909,522	\$4,835,829	\$494,370	\$12,649,377
Due From Other Accounting Entities	349		60,507		60,856
Expense Advances to Employees	500		1,000		1,500
Interest Receivable	70,285	304,307	11,612	50,317	436,521
Due from Federal Government	56,141		293,121		349,262
Investments	12,257,296	1,329,737	2,012,001	595,419	16,194,453
Loans Receivable	56,970,165		29,620,487		86,590,652
Total Assets	\$75,764,392	\$2,543,566	\$36,834,557	\$1,140,106	\$116,282,621
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts Payable			\$42,868		42,868
Due to Other Accounting Entities	20,255		162,339		182,594
Vouchers Payable			6,664		6,664
Deferred Revenue			10,800		10,800
Interentity Loans Payable	83,046		196,869		279,915
Total Liabilities	\$103,301	\$0	\$419,540	\$0	\$522,841
Fund Balances					
Reserved for Loans Receivable	\$56,970,165		\$29,620,487		\$86,590,652
Unreserved, Undesignated	18,690,926	2,543,566	6,794,530	1,140,106	29,169,128
Total Fund Balances	\$75,661,091	\$2,543,566	\$36,415,017	\$1,140,106	\$115,759,780
Total Liabilities and Fund Balances	\$75,764,392	\$2,543,566	\$36,834,557	\$1,140,106	\$116,282,621

The accompanying notes to the financial statements are an integral part of this statement.

MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
STATE REVOLVING FUND PROGRAMS
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
SPECIAL REVENUE AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2001

	<u>WATER POLLUTION CONTROL</u>		<u>DRINKING WATER</u>		(FOR MEMORANDUM ONLY) TOTAL
	<u>SPECIAL REVENUE</u>	<u>DEBT SERVICE</u>	<u>SPECIAL REVENUE</u>	<u>DEBT SERVICE</u>	
REVENUES:					
Federal Capitalization Grant Revenue	\$9,278,900		\$5,914,099		\$15,192,999
Interest Income on Investments	1,705,280	193,214	185,108	67,827	2,151,429
Interest Earnings	357,443	1,521,935	169,799	690,650	2,739,827
Administration and Origination Fees	343,734		177,860		521,594
TOTAL REVENUES	\$11,685,357	\$1,715,149	\$6,446,866	\$758,477	\$20,605,849
EXPENDITURES:					
Program Administration/Set-Asides	\$497,892		\$1,138,639		\$1,636,531
State In-Kind Services-RIT			20,227		20,227
TOTAL EXPENDITURES	\$497,892	\$0	\$1,158,866	\$0	\$1,656,758
Excess Revenues Over/(Under)	\$11,187,465	\$1,715,149	\$5,288,000	\$758,477	\$18,949,091
OTHER FINANCING SOURCES:					
General Obligation Bond Proceeds	\$2,690,000	\$3,311	\$3,190,001		\$5,883,312
<i>Operating Transfers In:</i>					
Recycled Transfers from Water Pollution Control SRF			9,289,977		9,289,977
Debt Service Sweep	117,094				117,094
Origination/Administrative Fee Transfer		233,786	64,932	112,927	411,645
Arbitrage Transfers In				8,102	8,102
Bond Cost of Issuance Transfer	5,985		100,306		106,291
Loan Loss Reserve Sweep	1,126,064				1,126,064
Total Other Financing Sources	\$3,939,143	\$237,097	\$12,645,216	\$121,029	\$16,942,485
OTHER FINANCING USES:					
Bond Principal		\$400,000		\$110,000	\$510,000
Bond Interest		657,412		246,979	904,391
Bond Cost of Issuance	55,365		155,354		210,719
Arbitrage Rebate Tax		15,899			15,899
<i>Operating Transfers Out:</i>					
Recycled Transfers to Drinking Water	4,032,158		5,173,963		9,206,121
Debt Service Sweep		117,094		91,958	209,052
Origination/Administrative Fee Transfer	233,786		177,859		411,645
Loan Loss Reserve Sweep		1,126,064			1,126,064
Total Other Financing Uses	\$4,321,309	\$2,316,469	\$5,507,176	\$448,937	\$12,593,891
Excess(deficiency) of revenues and other financing sources over/(under) expenditures and other financing uses	\$10,805,299	(\$364,223)	\$12,426,040	\$430,569	\$23,297,685
FUND BALANCE CHANGES:					
Fund Balance - July 1, 2000	\$64,871,628	\$2,904,454	\$23,988,977	\$709,537	\$92,474,596
Prior Period Adjustment	(15,835)	3,335			(12,500)
Adjusted Fund Balance - July 1, 2000	64,855,793	2,907,789	23,988,977	709,537	92,462,096
Fund Balance - June 30, 2001	\$75,661,092	\$2,543,566	\$36,415,017	\$1,140,106	\$115,759,781

The accompanying notes to the financial statements are an integral part of this statement.

**MONTANA STATE WATER POLLUTION CONTROL AND DRINKING
WATER STATE REVOLVING FUND PROGRAMS
SPECIAL REVENUE AND DEBT SERVICE FUND
NOTES TO FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2001**

1. Organization of the Programs

The State of Montana's Water Pollution Control State Revolving Fund (WPCSRF) Program was established pursuant to Title VI of the Federal Water Quality Act of 1987. This federal act established the WPCSRF program to replace the construction grants program to provide a flexible financing source to loan money at reduced interest rates to finance the construction of publicly owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the WPCSRF provides for low interest rate loans to finance the entire cost of qualified projects.

The State of Montana's Drinking Water State Revolving Fund (DWSRF) Program was established pursuant to Title XIV of the Safe Drinking Water Act. This federal act established the DWSRF program for states to make loans to community water systems and nonprofit non-community water systems. Instead of making grants to communities that pay for a portion of building drinking water treatment facilities, the DWSRF provides for low interest rate loans to finance the entire cost of qualified projects or to refinance debt obligations on projects, which began after July 1, 1993. The State of Montana first incurred expenditures in the DWSRF Program in SFY1997.

WPCSRF loans must be repaid within 20 years, while DWSRF loan agreements allow up to 30 years for repayment. All repayments of interest and principal must remain in the Fund. Both programs are capitalized through U.S. Environmental Protection Agency (EPA) grants. States are required to provide an additional 20 percent of the federal capitalization grant as matching funds in order to receive a grant.

The programs are administered jointly by the Department of Environmental Quality (DEQ) Technical and Financial Assistance Bureau, and the Department of Natural Resources and Conservation (DNRC) Conservation and Resource Development Division. The Fund does not have any full time employees. Both funds are charged for time spent on SRF activities by department employees. The charges include salaries and benefits of the employees and operating expenses, as well as indirect costs.

2. Summary of Significant Accounting Policies

A. State Revolving Fund (SRF) Program Fund Structure

Both programs use Special Revenue and Debt Service Funds, as appropriate, to report their financial position and the results of operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions and activities. Montana maintains a State Special Revenue and a Federal Special Revenue Fund. The SRF programs are blended from a part of each Special Revenue

Fund. A fund is a separate accounting entity with a self-balancing set of accounts. Special Revenue and Debt Service Funds are considered governmental funds.

A Special Revenue Fund accounts for the proceeds of specific revenue sources restricted to expenditures for specified purposes (other than expendable trusts or major capital projects). A Debt Service Fund accounts for resources accumulated for payment of principal and interest on general long-term obligation debt.

B. Basis of Accounting

The accounting and reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for on a current financial resources measurement focus. Only assets and current liabilities are generally included on their balance sheets. Governmental fund operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

These funds use the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable and available to finance expenditures of the fiscal period or are not received at the normal time of receipt. Revenues are deferred if material and received before the normal time of receipt or if received for a particular activity and the expense for that activity has not been incurred prior to fiscal year-end. Expenditures are recognized when the related fund liability is incurred, with the following exceptions:

- 1) principal and interest on long-term debt are recognized when due;
- 2) prepayments are accounted for as expenditures in the period of acquisition;
- 3) inventory items are considered expenditures when purchased.

3. Cash/Cash Equivalents

Cash and cash equivalents consist of funds deposited with the Montana State Treasurer, and investments categorized as cash equivalents, which are short-term, highly liquid investments with original maturities of three months or less.

<u>Risk Category 1</u>	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Fund</u>
Money Market Direct Investment	8,340,842	\$8,340,842	Various

4. Due from Federal Government

This classification consists of amounts expended and awaiting receipt of the federal capitalization grant reimbursement.

5. Investments

The Board of Examiners of the State of Montana authorizes the sale of general obligation bonds to provide the state match for the SRF programs through the issuance of an Indenture of Trust. The Board of Examiners is comprised of the Governor, Attorney General and the Secretary of State for the State of Montana. The Indenture of Trust specifies the eligible investments meeting defined rating and risk criteria in which the state may invest. The state invests funds through its trustee bank, US Bank, N.A.

<u>Security Type</u>	<u>Category 1</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Government Securities	\$15,903,652	\$15,903,652	\$16,194,451

6. Loans Receivable

Montana operates both SRF programs as direct loan programs. Loans made to communities through the Water Pollution Control Program are 83.33 percent funded by the federal capitalization grant, and 16.67 percent by the state match amount. Loans made by the Drinking Water Program are funded approximately 80 percent by the federal capitalization grant, and 20 percent by the state match amount. Loan funds are disbursed to the local agencies by the trustee bank as local agencies expend funds for the purposes of the loan and request reimbursement from the program. Interest is calculated from the date that funds are disbursed. Typically after the final disbursement has been made, the payment schedule is certified in the loan agreement and adjusted for the actual amounts disbursed. No provision for uncollectible accounts has been made as all loans are current, and management believes that all loans will be repaid according to the terms of the loan agreement.

The outstanding principal balance of all loans guaranteed by the WPCSRF Program as of June 30, 2001, is \$56,970,165. The outstanding principal balance of all loans guaranteed by the DWSRF Program as of June 30, 2001, is \$29,620,487.

Loans mature at various intervals through July 1, 2021. The scheduled principal payments on loans maturing in the years after 2001 are as follows:

<u>Year ending June 30:</u>	<u>WPCSRF Amount</u>	<u>DWSRF Amount</u>
2002	\$ 3,380,710	\$ 1,508,036
2003	\$ 3,005,800	\$ 1,570,800
2004	\$ 7,376,400	\$ 1,632,800
2005	\$ 3,308,800	\$ 1,533,900
2006 and thereafter	<u>\$ 39,898,455</u>	<u>\$ 23,374,951</u>
Total	\$ 56,970,165	\$ 29,620,487

As of June 30, 2001, the WPCSRF and DWSRF had authorized loans to public entities of the State of Montana that in the aggregate exceeded \$93 and \$54 million, respectively. The outstanding balances of the largest loans in each portfolio are as follows.

Water Pollution Control State Revolving Fund:

<u>Local Agency</u>	<u>Authorized Loan Amount</u>	<u>Outstanding Balance</u>
City of Helena	\$ 9,320,000	\$ 6,608,601
Big Sky County Water & Sewer	\$ 5,513,000	\$ 4,383,000
City of Butte-Silver Bow	\$ 5,307,390	\$ 1,544,390
City of Red Lodge	\$ 3,933,600	\$ 420,124
City of Kalispell	\$ 3,913,000	\$ 2,607,000
Flathead County Evergreen	\$ 3,600,000	\$ 2,440,000
City of Columbia Falls	\$ 2,650,000	\$ 2,005,533
City of Missoula Reserve SID 520	\$ 2,647,000	\$ 2,455,000
City of Missoula W/B Clarifier SID	\$ 2,465,000	\$ 813,000
City of Havre	<u>\$ 2,224,000</u>	<u>\$ 1,931,000</u>
Total	\$ 41,572,990	\$ 25,207,648

Drinking Water State Revolving Fund:

<u>Local Agency</u>	<u>Authorized Loan Amount</u>	<u>Outstanding Balance</u>
City of Havre II	\$ 8,401,000	\$ 2,037,560
City of Whitefish II	\$ 5,839,000	\$ 5,347,326
City of Laurel	\$ 5,250,000	\$ 3,942,939
City of East Helena	\$ 3,234,000	\$ 2,997,405
City of Great Falls	\$ 3,000,000	\$ 408,314
River Rock Water & Sewer	\$ 2,100,000	\$ 2,100,000
City of Glendive	\$ 1,829,000	\$ 1,525,246
Lockwood Water & Sewer	\$ 1,700,000	\$ 1,700,000
Ft. Peck Water & Sewer	\$ 1,520,000	\$ 1,051,500
Seeley Lake Water District	<u>\$ 1,340,000</u>	<u>\$ 1,239,000</u>
Total	\$ 34,213,000	\$ 22,349,290

7. Interest Receivable

This account represents interest owed by borrowers as of June 30, 2001, for their July 2001 payment. It represents the six months of interest accrued from the loan payment made in January 2001. It does not include interest payments received in June that were due July 2001. Interest payments received in June amounted to \$595,410 for the WPCSRF and \$393,729 for the DWSRF.

8. Bonds Payable

General Obligation Debt—WPCSRF

Principal Payments

<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range(%)</u>	<u>FY01</u>	<u>In Year of Maturity</u>	<u>Balance June 30, 2001</u>
1991B	\$ 2,595,000	5.00 - 6.80	\$ 95,000	\$ 215,000 (2014)	\$ 1,965,000
1994B	\$ 2,200,000	4.20 - 6.10	\$ 80,000	\$ 180,000 (2016)	\$ 1,845,000
1996C	\$ 2,765,000	3.75 - 5.75	\$ 105,000	\$ 120,000 (2017)	\$ 2,400,000
1998A	\$ 3,510,000	3.75 - 5.15	\$ 120,000	\$ 260,000 (2019)	\$ 3,275,000
2000B	\$ 3,325,000	4.25 - 5.60	\$ 0	\$ 270,000 (2021)	\$ 3,325,000
2001H	\$ 2,690,000	4.00 - 5.00	\$ 0	\$ 200,000 (2021)	\$ 2,690,000
Total	\$ 17,085,000		\$ 400,000	\$ 1,245,000	\$15,500,000

Debt Service requirements (principal and interest) for WPCSRF are as follows:

<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007+</u>	<u>Totals</u>
\$2,802,261	\$901,110	\$911,726	\$915,755	\$908,500	\$10,968,311	\$17,407,663

General Obligation Debt—DWSRF

Principal Payments

<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range(%)</u>	<u>FY01</u>	<u>In Year of Maturity</u>	<u>Balance June 30, 2001</u>
1998F	\$ 3,065,000	3.60 - 4.85	\$ 110,000	\$ 230,000 (2018)	\$ 2,955,000
2000A	\$ 2,990,000	4.25 - 5.60	\$ 0	\$ 240,000 (2021)	\$ 2,990,000
2001G	\$ 3,190,000	4.00 - 5.00	\$ 0	\$ 235,000 (2021)	\$ 3,190,000
Total	\$ 9,245,000		\$ 110,000	\$ 705,000	\$ 9,135,000

Debt Service requirements (principal and interest) for DWSRF are as follows:

<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007+</u>	<u>Totals</u>
\$567,737	\$721,823	\$733,593	\$729,458	\$724,728	\$11,157,003	\$14,634,342

Interest earnings from both programs have been and will be used to liquidate this long-term debt. The year of maturity refers to state fiscal year. The General Obligation Bonds Payable are blended into the General Long Term Debt Account Group on the State of Montana Comprehensive Annual Financial Report (CAFR) and are not included on the programs' financial statements.

9. Fund Balance

A portion of the fund balance in the WPCSRF and DWSRF has been reserved for Loans Receivable, indicating that a portion of the fund balance is not available for expenditure.

The WPCSRF and DWSRF programs are capitalized by grants from EPA and matching funds from the State of Montana. All grant funds drawn are recorded as revenue. As of June 30, 2001, EPA has awarded capitalization grants of \$89,279,000 to the State of Montana for the WPCSRF program, of which \$60,171,646 has been drawn for loans and administrative expenses. As of June 30, 2001, EPA has awarded capitalization grants of \$44,957,400 to the State of Montana for the DWSRF program, of which \$20,242,842 has been drawn for loans and administrative expenses. Montana has issued bonds totaling \$17,085,000 for use as state matching funds for the WPCSRF program and \$9,245,000 for use as state matching funds in the DWSRF program.

10. Federal Capitalization Grant Revenues

Actual draws of federal funds differ from the amount of Federal Capitalization Grant Revenue reported on the Statement of Revenues, Expenditures and Changes in Fund Balance. This occurs because state accounting policy requires federal special revenue funds reflect a zero fund balance at fiscal year-end (with the exception of "A" accruals). Consequently, if a positive fund balance exists, a deferred revenue is recorded. If a negative fund balance is reflected at fiscal year-end, a revenue accrual to record revenue is recorded to zero the fund balance.

The following is a reconciliation of federal revenues reported on the financial statements to federal cash actually drawn during the state fiscal year:

WPC-SRF

Federal Capital Grant Revenue – Financial Statement:	\$ 9,278,900
Adjustment at FYE 01 to Deferred Revenue	\$ (372,222)
Adjustment at FYE 01 to Due from Federal Government	<u>\$ (56,140)</u>
Total Federal Draws	\$ 8,850,538

DW-SRF

Federal Capital Grant Revenue – Financial Statement:	\$ 5,914,099
Revenue recognized at FYE 00, but drawn in FY01	\$ 0
Adjustment at FYE 01 to deferred Revenue	\$ (486,076)
Adjustment at FYE 00 to Deferred Revenue	\$ 426,425
Correction of miscoded draw	<u>\$ 28,447</u>
Total Federal Draws	\$ 5,882,895

11. Interest Income on Investments

This revenue represents interest earnings on investments in the various accounts within the Fund. All assets of the Fund are invested to the degree possible by the trustee in investment vehicles, ranging from cash equivalents to long-term investments.

12. Interest Earnings

This revenue represents interest earnings from loan repayments made by borrowers. A typical loan carries an interest rate of 4%. This 4% is comprised of a loan interest rate of 2.25%, as well as a .75% Loan Loss Reserve fee and a 1% special administration fee. The earnings for each of these components totaled \$1,089,265, \$432,670, and \$357,443 respectively. Disadvantaged communities can receive loans with an interest rate of 3%, where no special administration fee is levied.

13. Program Administration

This expenditure represents costs incurred by DEQ and DNRC to administer the SRF programs. This amount is limited to 4% of each grant award from the EPA. Program Administration appears under the Resource Development/Recreation function in the State of Montana's CAFR.

14. Other Financing Sources and Uses

Loan interest amounts received that exceed the debt service requirements are shown as a Financing Source and Use on the financial statements. The balance remaining in the Debt Service Account is transferred to the Investment Account. Both accounts are within the SRF fund. This occurs after payments are rendered to the bondholders on July 15 of each year. In the Arbitrage Certificate, this activity is termed a Debt Service Sweep.

Administration and Origination Fees are shown as both a Financing Source and Use of funds because the fees are initially recorded inside the Loan Account when disbursed. These revenues are then transferred to the Special Administration and Loan Loss Reserve Accounts, which are outside the Fund.

RIT Transfers In represent financial support provided to the programs utilizing state Resource Indemnity Trust (RIT) monies and are considered in-kind match dollars for both programs.

The Loan Loss Reserve Sweep represents monies in excess of the reserve requirement that are transferred from the Loan Loss Reserve Account to the Special Administration Account per the bond indenture. Both accounts are considered outside the fund.

The Arbitrage Rebate Transfer reflects monies transferred into the Rebate Account (outside the fund) based on the annual arbitrage rebate liability calculation.

Recycled Fund transfers are transfers between the principal accounts in the WPCSRF and the DWSRF fund as allowed in Federal and State law as exercised by the Governor of the State.

15. Subsequent Events

The 1991B Water Pollution Control bonds were paid off on July 15, 2001 in full. They were scheduled to be paid off on July 15, 2013. The payoff amount was \$1,965,000 in principle and \$64,750 in interest costs.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Our audit was conducted for the purpose of forming an opinion on the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements taken as a whole. The Schedule of Revolving and Non-Revolving SRF Program Assets, Special Revenue and Debt Service Funds, for the Montana Water Pollution Control Program and the related Schedule of Revolving and Non-Revolving SRF Program Revenues, Expenditures, and Changes in Fund Balance, Special Revenue and Debt Service Funds are presented for purposes of additional analysis and are not a required part of the financial statements of this program. Such information has been subjected to the auditing procedures applied in the audit of the programs' financial statements and, in our opinion, based upon our audit, is fairly presented in all material respects in relation to the programs' financial statements taken as a whole.

Respectfully submitted,

A handwritten signature in black ink that reads "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 16, 2002

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAM ASSETS
SPECIAL REVENUE AND DEBT SERVICE FUNDS
REGULATORY BASIS
JUNE 30, 2001**

	WPC-SRF		WPC-SRF		DRINKING WATER		(FOR MEMORANDUM ONLY)
	STATE SPECIAL REVOLVING FUND	NON- REVOLVING FUND	DEBT SERVICE REVOLVING FUND	NON- REVOLVING FUND	STATE SPECIAL REVOLVING FUND	NON- REVOLVING FUND	
ASSETS							
Cash/Cash Equivalents	\$6,274,580	\$135,076	\$683,968	\$225,554	\$1,494,339	\$3,341,190	\$394,756
Due From Other Accounting Entities	349				60,507		
Advances to Employees	500				1,000		
Interest Receivable		70,285	210,856	93,451		11,612	35,225
Due from Federal Government	56,141				293,121		
Investments	9,092,284	3,165,012		1,329,737	1,546,883	465,118	
Loans Receivable	56,970,165				29,620,487		
Total Assets	\$72,394,019	\$3,370,373	\$694,824	\$1,648,742	\$33,016,637	\$3,817,920	\$429,981
						\$710,125	\$116,282,621
LIABILITIES AND FUND BALANCES							
Liabilities:							
Accounts Payable					42,868		42,868
Due to Other Accounting Entities	20,255				162,339		162,594
Unearned Revenue					5,664		6,664
Deferred Payments					10,800		10,800
Interfund Loans Payable	83,046				106,250		279,915
Total Liabilities	\$103,301	\$0	\$0	\$0	\$419,140	\$0	\$322,841
Fund Balances							
Reserved for Loans Receivable	56,970,165	0	0	0	29,620,487		86,590,652
Unreserved, Undesignated	15,320,553	\$3,370,373	894,824	1,648,742	2,976,510	3,817,920	710,125
Total Fund Balances	\$72,290,718	\$3,370,373	\$894,824	\$1,648,742	\$32,597,097	\$3,817,920	\$115,755,780
Total Liabilities and Fund Balances	\$72,394,019	\$3,370,373	\$894,824	\$1,648,742	\$33,016,637	\$3,817,920	\$116,282,621

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated revolving fund (within the Fund) and Non-Revolving Fund (outside the Fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the Revolving Fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

FOR THE FISCAL YEAR ENDED JUNE 30, 2001

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis. As required by the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Program, this presentation separates certain required Revolving Fund (within the Fund) and Non-Revolving Fund (outside the Fund) activity by fund type. All proceeds from the EPA Capitalization Grant, other corresponding state matching funds, and loan principal and interest repayments must be deposited into the Revolving Fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Loss Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

(1) Generally Accepted Accounting Principles (GAAP).

LEGISLATIVE AUDIT DIVISION

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Legislative Audit Committee
of the Montana State Legislature:

We have audited the financial statements of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of and for the fiscal year ended June 30, 2001, and have issued our report thereon dated October 16, 2002. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

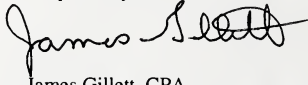
Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Departments' (Department of Environmental Quality and Department of Natural Resources and Conservation) internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that a misstatement in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in

the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be a material weakness.

This report is intended solely for the information and use of the Legislative Audit Committee, department management, the Montana State Legislature, and the U.S. Environmental Protection Agency and is not intended to be, and should not be, used by anyone other than these specified parties. This report is a matter of public record and its distribution is not limited.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James Gillett", with a stylized flourish at the end.

James Gillett, CPA
Deputy Legislative Auditor

October 16, 2002

